SB 675

Department of Legislative Services

Maryland General Assembly
2010 Session

FISCAL AND POLICY NOTE

Senate Bill 675 (Senators Kittleman and Jacobs)
Finance

Unemployment Insurance - Exemption from Covered Employment - Small Business Directors, Officers, and Members

This bill exempts from unemployment insurance (UI) coverage work performed for monetary compensation by a director or officer of a corporation or a member of a limited liability company (LLC) that employs 50 or fewer employees.

Fiscal Summary

Unemployment Insurance Trust Fund (UITF): UITF revenues decrease by $92.5 million in FY 2011 as UI taxes are not assessed on certain directors or officers of corporations and certain members of LLCs. Future year revenues reflect a reduction in employer charge-backs and annualization. UITF expenditures decrease by $26.0 million in FY 2011 for decreased UI benefits payments. Future years reflect increases in average weekly benefit amounts and annualization.

($ in millions)	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
UITF Revenues	($92.5)	($108.3)	($116.0)	($123.8)	($126.3)
UITF Expenditures	(26.0)	(35.7)	(36.7)	(37.8)	(39.0)
Net Effect	($66.5)	($72.7)	($79.2)	($86.0)	($87.3)

State Effect: Potential significant loss of federal UI revenues if a determination is made that Maryland law is out of conformity with federal unemployment insurance law, as discussed below.

Local Effect: None. The bill does not affect local governments.

Small Business Effect: Potential meaningful.

Analysis

Current Law: Covered employment is defined as work performed by an individual for an employing unit. For businesses that are incorporated, employees that are directors and officers are considered covered for UI purposes. Employees that are members of LLCs are also considered covered for UI purposes.

For businesses organized as a sole-proprietorship, the owner is not considered covered for purposes of UI. For businesses that are organized as partnerships, the partners are not considered covered for purposes of UI.

Background: Unemployment benefits are funded through Maryland employers' State UI taxes. All private business employers and nonprofit employers employing one or more persons, at any time, are subject to the Maryland Unemployment Insurance Law. An employer's tax rate is based on the employer's unemployment history and ranges within a certain percentage of the total taxable wages of the employer's employees. The taxes are deposited in UITF and can be used only to pay benefits to eligible unemployed individuals.

An individual performing services for a business in return for compensation in the form of wages is likely covered for UI purposes. The employer reports the wages to the Division of Unemployment Insurance and pays UI taxes on those wages. If a person is not a covered employee, the person's wages are not reported, and the employer does not pay UI taxes for those services.

The Federal Unemployment Tax Act (FUTA) requires all services performed by employees of state and local governments, certain nonprofit organizations, and federally recognized Indian tribes, to be considered covered employment by state law unless they are specifically exempted by federal law. Most exemptions from covered employment under Maryland law mirror FUTA exemptions. Maryland has enacted State-only exemptions not included in FUTA (*e.g.,* yacht salespersons, Class E and F truck drivers, recreational sports officials, and messenger service drivers), but they do not apply to State and local government or certain nonprofit organizations. If State law does not cover services performed for State and local governmental entities, federally recommended Indian tribes and certain nonprofit organizations, as required by FUTA, the result is the loss of certification for *all* employers in the State.

Unemployment Insurance Trust Fund Effect:

Trust Fund Revenues

In general, UITF revenues decrease for each employee exempted from UI coverage as employers no longer make UI contributions for exempt employees. UITF revenues also decrease from a reduction in employer charge-backs, which an employer would be charged to repay a portion of UI benefits paid to former employees.

DLLR estimates that there are 100,780 corporations and LLCs subject to UI taxes with 50 or fewer employees. This represents approximately 73% of all active employers. Exempting officers and directors of these corporations and partners of these LLCs from UI taxes will reduce employer contributions to UITF by $92.5 million in fiscal 2011, which accounts for the bill's October 1, 2010 effective date. Future year UITF tax revenues decrease by $102.8 million annually. The following facts and assumptions were used in determining the decrease in UITF revenues:

- each corporation has three officers or directors and each LLC has three members; and
- the first $8,500 of an employee's earnings are taxed for UI purposes at a rate of 4%.

Of the amount of UI benefits paid to individuals, approximately 64.1% of the benefits paid are charged back to one or more employers over a three-year period, beginning the year following benefits payment. The difference that cannot be charged back to private-sector employers is, ultimately, recovered through premiums paid by all employers. As UITF expenditures decrease, UITF revenues from employer charge-backs are also reduced. Thus, UITF revenues further decrease by $5.5 million in fiscal 2012, by $13.2 million in fiscal 2013, by $21.0 million in fiscal 2014, and by $23.5 million in fiscal 2015.

Legislative Services advises that State law requires that a Maryland corporation have three officers – a president, a secretary, and treasurer. A person may hold more than one office in a corporation but may not serve as president and vice-president concurrently. In addition to the three required officers, a Maryland corporation may appoint any other officer as allowed in the bylaws of the corporation. The fiscal estimate provided above assumes that each corporation has three officers. To the extent Maryland corporations appoint more than three officers, the reduction in UITF revenues as a result of the bill may be considerably greater than estimated.

Trust Fund Expenditures

DLLR estimates that approximately 3,000 employer accounts closed in 2009 and 73% of these accounts were corporations or LLCs with 50 or fewer employees. Directors and officers of these corporations and members of these LLCs that become exempt from UI coverage will no longer be eligible to receive UI benefits. Based on the number of UI benefits paid in 2009, UITF expenditures decrease by $26.0 million in fiscal 2011, which accounts for the bill's October 1, 2010 effective date. UITF expenditures decrease by $35.7 million in fiscal 2012, by $36.7 million in fiscal 2013, by $37.8 million in fiscal 2014 and by $39.0 million in fiscal 2015. The following facts and assumptions were used in this estimate:

- the average weekly benefit amount is $310 and increases by 3% each year;
- each benefit recipient receives on average 17 weeks of unemployment benefits; and
- approximately 2,190 corporations and LLCs with 50 or fewer employees close employer accounts each year.

State Fiscal Effect: The administration of Maryland's UI program is 100% federally funded. The Maryland Unemployment Insurance Program receives at least $69.0 million annually. Under a worst-case scenario, if Maryland were found to be out of conformity with federal law, administrative funding provided by the federal government may be cut.

Many not-for-profit organizations are structured as nonprofit corporations. Under the bill there is nothing to preclude these organizations from exempting officers and directors from UI coverage. Under provisions of FUTA, services performed by employees of not-for-profit organizations and governmental entities can only be exempt from UI coverage if the services are exempt under FUTA. These employees are not exempt under FUTA.

Small Business Effect: If State law does not cover services performed for State and local governmental entities, federally recognized Indian tribes and certain nonprofit organizations under UI, as required by FUTA, the result is the loss of certification for *all* employers in the State.

For employers with employees that are exempt from UI coverage under State law, State UI tax liability will decrease; however, as these services are not exempt under federal law, federal unemployment tax liabilities will increase. If an employer has paid all State taxes due on services, then the employer is allowed a federal unemployment tax credit under which the employer pays 0.8% of the first $7,000 in wages of each employee or $56 per employee per year. If State UI taxes are not paid on these employees, then the tax credits are not allowed and the employer must pay the full federal tax of 6.2% or $434 per employee per year.

Of the amount of UI benefits paid to an individual, a portion of benefits paid are charged back to the individual's prior employer. Under current law, if a corporation or partnership goes out of business, there is no employer to charge benefits to and the costs of benefits paid become a socialized cost for all employers. To the extent the bill reduces socialized costs on all employers, small businesses with employees covered under UI benefit.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Department of Labor, Licensing, and Regulation; Department of Legislative Services

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